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November 16, 1994

Mr. William Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: MM Docket Nos. 93-215 and 92-266
Comments on Fifth Reconsideration Order

Dear Mr. Caton:

Attached please find an original and four copies of the above-referenced pleading of Avenue TV Cable, Massillon Cable TV, Pegasus Cable and Thompson Cable Vision Co.

Please contact the undersigned counsel if you have any questions regarding this submission.

Sincerely yours,

Thomas B. Magee
Attorney for
Avenue TV Cable
Massillon Cable TV
Pegasus Cable
Thompson Cable Vision Co.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section of	)	MM Docket No. 93-215
the Cable Television Consumer	)	
Protection and Competition Act	)	MM Docket No. 92-266
of 1992: Rate Regulation	)	

COMMENTS OF AVENUE TV CABLE, MASSILLON CABLE TV, PEGASUS CABLE AND THOMPSON CABLE VISION CO.

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November 16, 1994

SUMMARY OF ARGUMENT

Commenters respectfully contend that the previous relief offered to small-sized cable operators by the Commission was based on the misperception that only small operators of 15,000 subscribers or less might incur higher than average costs. In fact, cable operators generating annual revenues of $25 million also must bear above-average costs, and have difficulty generating unregulated revenue to counteract these costs. As explained, these additional costs include administrative and regulatory costs, disproportionate construction costs, higher operating expenses, greater capital costs, higher programming costs, and higher costs for the addition of channels.

In order to create a more level playing field for operators experiencing above-average costs, Commenters respectfully request the Commission to grant the following relief to "Smaller Operators," defined as those operators generating annual revenues of $25 million or less: (i) a cost study should be conducted to evaluate the extent of their above-average costs; (ii) transition relief from rate reductions should be permitted pending the outcome of these cost studies; (iii) a streamlined cost of service option should be made available which uses average costs developed from the cost studies; and (iv) upgrade costs should be preapproved and eligible for pass-through as incurred.

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In the Matter of	)	
	)	
Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
	)	MM Docket No. 92-266

COMMENTS OF AVENUE TV CABLE, MASSILLON CABLE TV, PEGASUS CABLE AND THOMPSON CABLE VISION CO.

Avenue TV Cable, Massillon Cable TV, Pegasus Cable, and Thompson Cable Vision Co. (hereinafter collectively referred to as "Commenters"), by counsel, hereby submit their Comments in response to the Fifth Order on Reconsideration and Further Notice of Proposed Rulemaking released September 26, 1994 in the above-captioned proceeding ("Fifth Reconsideration").[1] In support of their Comments, Commenters state as follows:

I. INTRODUCTION

Avenue, Massillon, Pegasus and Thompson applaud the Commission for its sensitivity to market realities in soliciting comments in the Fifth Reconsideration as to which cable operators should be eligible for regulatory relief. Commenters respectfully contend that the previous relief offered to small-sized cable operators by the Commission was

[1] FCC 94-234.

based on the misperception that only small operators of 15,000 subscribers or less might incur higher than average costs. This misperception resulted in the decision by the Commission not to extend sorely-needed regulatory relief to a larger universe of cable operators.

In the above regard, Commenters wish to share with the Commission their experiences as small-sized operators with the costs of constructing and operating cable systems, the costs of providing cable service to subscribers, the costs and difficulties with complying with rate and other regulatory requirements, and the problems associated with upgrading their systems. In addition, Commenters will explain their difficulties experienced in raising unregulated revenues.

Commenters respectfully contend that their analysis of cable operator costs and revenues applies to cable operators generating $25 million in annual gross revenues.[2] Their analysis concludes that operators of this size, which Commenters will refer to as "Smaller Operators," incur costs greatly in excess of average costs for cable operators as a whole, and are much less likely to ease the burden of these higher costs with unregulated revenues. Consequently, Commenters respectfully request the Commission

[2]By suggesting $25 million as the cut-off for "Smaller Operators" which should be eligible for regulatory relief, Avenue, Massillon, Pegasus and Thompson do not wish to suggest that a higher figure could not also be justified, as the Commission may wish, <u>sua sponte</u>, to conclude.

to provide Smaller Operators with the regulatory relief outlined below.

II. ARGUMENT

A. The Commission Must Acknowledge that Smaller Operators Face Greater Costs than Other Cable Companies

1. Administrative and Regulatory Burdens

Many Smaller Operators provide cable service in rural areas, often using multiple headends. Because the geographic areas served by Smaller Operators are usually quite large, the Smaller Operator's headends often serve multiple franchise areas, and the full panoply of regulatory requirements attach to every one. Further, Smaller Operators owning numerous small systems are burdened by extensive and complex FCC regulatory requirements. Commenters have learned all too well and painfully that even the preparation of paperwork sufficient to cover FCC and local regulations for multiple systems and numerous franchising authorities has become an overwhelming and expensive task. The regulations include not only rates, but paper-intensive reporting and file requirements associated with signal carriage issues, must-carry requirements, and customer service standards, to specify but a very few. The greater the number of systems operated by a Smaller Operator, the greater the amount of regulatory paperwork that must be processed. Evidencing this regulatory overload, many Smaller Operators have unfortunately been unable to take advantage of the "safety net" cost of service showing, because of its complicated, time-consuming nature, and because such filings strain the limited resources available to them.

Their experiences with such administrative and regulatory burdens have unhappily taught Smaller Operators that they are unable to manage adequately the costs of complying with these regulations. The primary reason for this is simple: the systems operated by Smaller Operators have so few subscribers they do not generate revenues sufficient to cover the expense of hiring enough employees to handle these requirements. In addition, outside legal and accounting expertise that is so clearly required to satisfy the regulatory requirements is so expensive that Smaller Operators are unable to obtain adequate assistance to comply with FCC and local franchising authority rate regulations in a manner that is thorough and in the best interests of both the cable operator and the public. It is unrealistic and fundamentally unfair for the Commission to expect Smaller Operators to comply with its rate regulations to the same extent as larger operators.

2. Construction Costs

Because of the smaller number of subscribers per area served, construction costs are comparatively greater for Smaller Operators. A mile of cable generally costs approximately $15,000 to install, no matter where it is located. However, Smaller Operators located in sparsely populated areas will have fewer subscribers through which these costs can be recovered. It is really that simple. Additionally, since rural communities are spread out along only a few main roads, rural cable systems have a higher trunk to feeder ratio than either suburban or urban systems, which raises the construction cost per mile.

These costs of laying cable are particularly difficult for Smaller Operators to pay. For example, Smaller Operators so not receive volume discounts from suppliers. When buying hardware, cable, bolts, taps, and other supplies, a purchaser laying 100 miles of cable pays much more per unit of supplies than one laying 1000 miles. Additionally, discounts are not offered by the contractors who are necessary for such construction. Furthermore, Smaller Operators have difficulty meeting the engineering costs required for many upgrades. For instance, an outside consultant with sufficient expertise to advise on a proposed upgrade to fiber optics must be hired for $250-300 per hour. These rates must be paid no matter what the size of the operator, but Smaller Operators are less able to cover such costs because the upgrade affects fewer subscribers. It is small wonder, then, that many cable companies do not wish to operate in rural areas and that so many rural areas continue either to have no or only substandard cable service.

3. Operating Costs

The costs of headend hardware is the same whether a system services 5,000 subscribers or 100,000. Fixed costs, such as those for headend equipment, disadvantage Smaller Operators, which often face serious difficulties passing these costs through to a limited subscriber base. The fixed cost problem with headend hardware is compounded by the fact that an inventory of spare headend equipment and headend parts must also be maintained.

Operating expenses for Smaller Operators providing service in rural areas generally exceed those of operators servicing more densely populated areas. Because of the wider area that must be covered by many Smaller Operators for new installations and service calls, rural operators must operate more vehicles and incur greater expenses for such items as fuel and truck maintenance, and automobile insurance. Additional time spent travelling is also a factor. In addition, longer drops are generally required for new subscribers in a rural area because houses typically are set further back. The longer drops increase the cost for hooking up new subscribers.

Additional fixed costs place Smaller Operators at a further disadvantage. Once again this is so because Smaller Operators have a limited ability to recover these costs over a smaller subscriber base. Fixed costs such as telephone, electricity and other utility expenses, personnel,[3] property taxes, pole rentals, plant maintenance, and other plant expenses have a disproportionate impact on Smaller Operators. This is also true with regard to the equipment required for compliance with FCC-required headend and distribution system proofs.

The problem raised by spreading fixed costs over fewer subscribers is intensified for Smaller Operators in instances where Smaller Operators pay higher costs than larger operators. For example, for obvious reasons Smaller Operators cannot avail themselves of the volume discounts that hardware suppliers will grant to larger MSOs. The combination of these disadvantages makes profitability difficult for Smaller Operators.

Smaller Operators are even becoming reliant on services offered by larger operators which, of course, places Smaller Operators in the position of contributing part of their limited revenues to pay for the profits of larger operators. For example, services such as Tele-Communications Inc.'s National Digital Television Center, known as the "headend in the sky," will be available to some Smaller Operators but only at a substantially greater expense than larger operators incur to provide similar services.

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[3]Personnel problems abound for Smaller Operators which, as with smaller companies in other industries, often train personnel from scratch only to see them leave for more attractive opportunities in the industry.

Smaller Operators are disadvantaged in their efforts to provide better and more advanced services to subscribers. Unlike larger operators, they have little or no capacity for experimentation or research; research personnel simply cost too much per subscriber. Additionally, manufacturers will not work with Smaller Operators to fabricate new equipment because the markets served by Smaller Operators are too small. Experimentation by Smaller Operators does not occur because meaningful experimentation in a small market can be done only if the Operator risks inclusion of all of its subscribers.

Along with their inability to innovate, Smaller Operators have difficulty adopting new technologies. By the time Smaller Operators determine which technology will work on their systems, they are often already a generation behind. In an industry where continual upgrading is required by the rapid development of technology, Smaller Operators are unable to keep pace and are often simply left in the dust.

4. **Cost of Capital**

Because of high perceived risks and the lack of potential investors, the cost of capital is greater for Smaller Operators. Equity returns in the range of 25-40% often are necessary to attract capital. The lack of affordable financing has a detrimental effect now and will continue to be detrimental in the future since sufficient funds may be unavailable to finance much-needed system upgrades. If not already required, these upgrades will be necessary for Smaller Operators to meet new competition, new technology, and franchisor demands for state-of-the-art systems.

5. Programming Costs

Large volume discounts exist to reduce programming costs, but none of these discounts is available to Smaller Operators. Generally speaking, these discounts are available only to operators with over 100,000 subscribers. In addition to discounts, Smaller Operators are also denied certain other benefits which programmers make available to larger operators, such as staff training and discretionary and co-operative advertising money.

Apart from outside programming, Smaller Operators find it difficult to provide discretionary or mandated local origination programming because the costs for such programming are too high on a per subscriber basis. The fixed costs of adequate studios and equipment are the same regardless of system size or market. As a consequence, the larger the system, the lower the per subscriber cost for local programming. Moreover, on a per subscriber basis, the variable costs of program production, which include such things as rights fees, personnel, electricity, etc., decline as the subscriber base increases. Other cost saving measures are available to larger operators alone. For instance, large operators can share production facilities among multiple systems. Also, many large operators benefit from the availability of vertically integrated programming sources to the detriment of Smaller Operators, who are generally devoid of such relationships.

6. Addition of Channels

Smaller Operators have difficulty adding channels to their cable systems because, once again, the fixed costs required to add a channel are not easily recovered from a limited subscriber base. This problem, of course, is multiplied for Smaller Operators with a large number of headends.

B. Smaller Operators Generate Lower Revenues

1. Smaller Operators are Unable to Generate Unregulated Revenue to the Same Extent as Large Operators

Smaller Operators have more limited opportunities to generate unregulated revenues than larger operators. For instance, local advertising dollars are not nearly as abundant for Smaller Operators. One reason is that insertion equipment necessary to generate local advertising revenue may not be affordable. The hardware costs for insertion equipment are fixed. The small subscriber base of Smaller Operators is limited to the extent that Smaller Operators can only afford low cost, run of schedule equipment. In contrast, larger markets can afford sophisticated equipment, such as random access or fixed position insertion equipment. Selling spots on this basis is both easier and far more profitable. Another reason local advertising dollars are less plentiful is that fewer sponsors of advertising are available in smaller communities. In addition, the larger advertisers spend less money per household in the smaller markets. Finally, since operators in smaller markets must compete with radio, television and newspapers for advertising (which provide free production), Smaller Operators must typically provide free or low-cost commercial production.

Smaller Operators are also less capable of offering pay-per-view and other premium services because of high equipment costs and limited channel capacity. Even if channel capacity and adequate equipment were available, fixed operating costs required for pay-per-view make such a service offering unprofitable for smaller systems. To illustrate, a barker channel must be provided before pay-per-view can be offered, at a minimum cost of $750-800 per month. In addition, a data line is required to fill the orders themselves. On top of a flat rate of $0.25 per order, the line charge totals approximately $550 per month. Finally, the movie or event distributor receives over 50% of the revenue, equalling at least $2.00 of a $4.00 movie price. After subtracting $0.25 for the flat rate to cover the order, the operator receives $1.75 per order to pay for what is at least $1,300 in fixed costs per month. Given these operating costs, approximately 750 movies must be sold in any one system before the operator has received any return at all. Since the average buy rate on pay-per-view is only 20%, a system would need at least 3750 subscribers to make pay-per-view a potential source of unregulated revenue. These 3750 subscribers, moreover, must have addressable converter equipment. Because many smaller systems lack this equipment, pay-per-view for Smaller Operators is not frequently offered. On the other hand, larger systems, with addressable equipment and large subscriber bases, are able to generate a great deal of revenue through pay-per-view services. In addition to enjoying a large subscriber base, larger operators also make use of sophisticated billing systems which are capable of absorbing dataline charges that are unavoidable for Smaller Operators.

2. Revenues Per Subscriber are Lower in Smaller Cities Where Smaller Operators Typically Provide Service

Because residents in rural areas and smaller cities generally have incomes below residents in suburban and urban areas, the amount of discretionary income available to subscribers in smaller cities is limited. Lower discretionary income results in lower revenue per subscriber because of lower buy rates on premium and other services. As discussed previously, Smaller Operators tend to be located in rural areas or smaller cities.

C. **Numerous Policy Reasons Exist for Offering Relief to Smaller Operators**

Because the Commission has not yet taken full account of the unique and unavoidable high costs incurred by Smaller Operators to provide cable service, current regulations actually penalize Smaller Operators for attempting to construct systems in low density areas that other companies do not want to service. It is unfair and inappropriate for the Commission to expect that Smaller Operators play by the same regulatory rules as bigger operators.

Current rate regulations have left Smaller Operators confused as to their obligations, out of pocket for a great amount of legal and accounting expenses, uncertain about their regulatory future and about their ability to stay profitable, and unable to raise sufficient capital to finance upgrades.

If adequate financing for upgrades were available to Smaller Operators, their subscribers would enjoy better services and Smaller Operators would have the ability to meet current and future competition on a more level playing field. Without upgraded cable systems, many rural areas and smaller cities in this country will be consigned to inferior communications systems. This is surely not part of the future envisioned for the information superhighway by Vice President Gore and the Commission. In order for rural areas to share in and contribute to the communications revolution, certain administrative understanding and leniency is required to provide Smaller Operators to ability to construct new systems and upgrade existing ones.

Finally, Congress has indicated that administrative burdens should be kept at a minimum for Smaller Operators. For instance, Section 623(b)(2)(A) of the 1992 Cable Act specifically requires the Commission to "seek to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission." 47 U.S.C. § 543(b)(2)(A). The Small Business Act, for its part, is based on the declared policy of Congress that the "Government should aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns." 15 U.S.C. § 631(a). The Commission has a unique opportunity to make these policy declarations into a meaningful reality for Smaller Operators in this proceeding.

III. <u>THE RELIEF PROVIDED BY THE COMMISSION FOR SMALLER OPERATORS SHOULD EASE REGULATORY BURDENS FOR SMALLER OPERATORS, PROVIDE THEM A MEANS TO REMAIN PROFITABLE, AND ENCOURAGE CONSTRUCTION OF MUCH-NEEDED UPGRADES</u>

A. <u>The Commission Should Conduct a Study to Evaluate Costs Incurred by Smaller Operators</u>

The Commission should expand its current cost studies to include Smaller Operators. As demonstrated above, Smaller Operators incur costs far above the cable industry average. These greater costs make application of the benchmark and current cost of service regulations inappropriate and unfair, and justify taking a hard look at the disparity of burdens on large operators as compared to Smaller Operators. At the end of such a cost analysis, Commenters confidently believe that considerable evidence will be available for the Commission to determine that the full rate reduction required in the <u>Second Reconsideration</u>[4] order is simply not appropriate for Smaller Operators.

B. <u>Transition Relief Should be Granted to Smaller Operators Identical to That Provided Currently for Small Operators</u>

Because the reasons for analyzing the costs incurred by Smaller Operators are just as meritorious as those for small operators, the Commission should grant Smaller Operators the same transition relief available now

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[4] "Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation," <u>Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking</u>, 74 RR2d 1077, MM Docket No. 92-266 (rel. Mar. 30, 1994).

to small operators. On a prospective basis, Smaller Operators should not be required to justify their rates with benchmark or cost of service filings until the Commission's cost studies are completed. Cable systems which already have filed forms with either the Commission or local franchising authorities should have all ongoing rate proceedings and rate orders stayed, pending the Commission's final analysis of Smaller Operator costs and prices.

C. Using the Results of its Cost Studies, the Commission Should Develop a Streamlined Cost of Service Alternative for Smaller Operators

When cost studies of Smaller Operators are complete, the Commission should develop average costs which may be used to offer Smaller Operators the ability to file a simpler, streamlined cost of service showing. A streamlined cost of service mechanism would greatly ease the regulatory burden of Smaller Operators, the Commission, and local franchising authorities. Smaller Operators would save the enormous expenses now incurred for extra personnel and for outside accounting and legal expertise.

The streamlined cost of service alternative for Smaller Operators should employ the results of the Commission's cost studies by incorporating certain average costs. Using the results of the cost studies, the Commission should develop average costs for such items as: (i) customer service expenses per subscriber; (ii) programming expenses per subscriber; (iii) administrative and general expenses per subscriber; (iv) plant costs per mile of cable; (v) technical service costs per mile of cable; (vi) headend costs per channel; and (vii) equipment costs. In completing their streamlined cost of service filings, Smaller Operators would multiply these average costs by the number either of channels, cable miles, subscribers, or equipment units, as appropriate.

The streamlined cost of service alternative for Smaller Operators should also include a substantially greater rate of return than the 11.25% overall rate currently offered as a presumption in standard cost of service filings. A much greater rate of return should appear justified after the Commission analyzes the difficulties faced by Smaller Operators in attracting capital.

Although average costs should be developed by the Commission for use in the streamlined filing, Smaller Operators should be permitted to rebut these average cost figures as necessary. Thus, if an average cost figure supplied by the Commission is smaller than the cost actually incurred on the system filing the streamlined form, that system should be permitted to justify and employ the higher number.

A streamlined cost of service mechanism employing average cost figures should provide Smaller Operators with a chance to earn reasonable profits while avoiding cumbersome, costly, and extensive cost of service showings. Smaller Operators should still be permitted, however, to justify their rates based upon a full-blown cost of service showing.

D. <u>The Commission Should Preapprove Upgrade Costs for Smaller Operators and Permit These Upgrade Costs to Be Passed-Through When Incurred.</u>

As discussed above, Smaller Operators struggle to afford new technology that is becoming increasingly necessary to allow them to compete and to provide adequate communications service. Without the ability to finance system upgrades, many rural and small communities will be denied the benefits of new generation equipment. For many Smaller Operators, financing system upgrades is only possible if investors are offered a timely, dependable return on their investments. The Commission should thus grant Smaller Operators preapproval of proposed system upgrades and the ability to recover the costs of these upgrades at the time these costs are incurred. In this way, investors will feel comfortable in making investments in Smaller Operators which can then provide necessary and modern communications services to those areas which would otherwise be left behind.

IV. CONCLUSION

Smaller Operators should at a minimum be defined as operators with $25 million or less in annual revenues. As demonstrated, Smaller Operators are subject to numerous and substantial cost burdens which larger operators simply do not experience. To provide a more level playing field for Smaller Operators, Commenters respectfully request the Commission to: (i) include Smaller Operators in ongoing cost studies; (ii) provide Smaller Operators with transition relief until such time as the cost studies are completed; (iii) provide a streamlined cost of service option for Smaller Operators based on the cost studies; and (iv) allow

Smaller Operators to obtain pre-approval for upgrade costs, allowing these costs to be passed through when incurred.

Respectfully submitted,

AVENUE TV CABLE
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